



**APEC BUSINESS ADVISORY COUNCIL  
2019 REPORT TO APEC FINANCE MINISTERS**

**ACHIEVING INCLUSIVE GROWTH  
THROUGH  
FINANCIAL INCLUSION, INNOVATION AND  
INTEGRATION**



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## **APEC BUSINESS ADVISORY COUNCIL 2019 REPORT TO APEC FINANCE MINISTERS**

### **Summary of Recommendations**

#### **1. CREATING THE DIGITAL AND POLICY ECOSYSTEM FOR FINANCIAL INCLUSION**

##### **Accelerating Financial Innovation: The Role of Regional Public-Private Platforms**

APEC Finance Ministers should encourage collaboration among regulators, industry and multilateral institutions to develop, implement, link together and deepen participation in public-private sector platforms for financial innovation across the region. As a first step forward, we recommend that APEC convene a Roundtable in Latin America to share Asian experiences with platforms that facilitate international partnerships among banks and fintech firms to design, test and deploy innovative products, and to develop the concept for a Latin American platform that can be linked with Asian counterparts.

##### **Harnessing Data for Financial Inclusion**

Economies should promote wider collection and sharing of traditional and alternative data, including both negative and positive credit data, as well as unstructured data (Big Data) and take steps to improve availability, connectivity and quality of information.

Economies should engender trust in wider cross-border data flows by collaborating to develop inter-operable privacy regimes among themselves and with other key jurisdictions taking into account member economies' domestic laws, policies and priorities, and by cooperating to promote a strong regional data security environment.

##### **Digitalizing Trade and Supply Chain Finance**

APEC economies should undertake measures to ensure that legal and regulatory frameworks around digital documents used in trade are inter-operable across the region, and support standardization of market practices.

##### **Building the Ecosystem for a Modern Movable Finance Market**

APEC should initiate capacity building programs for interested economies under the Cebu Action Plan's Financial Infrastructure Development Network (FIDN) to build a modern movable finance market focusing on market development, digitalization and globalization.

##### **Expanding Access to a Broader Range of Financial Services**

APEC developing economies should undertake reforms to expand access of rural and low-income consumers and micro-enterprises to savings, insurance and pensions, using digital technology, and promote financial literacy.

##### **Creating Inclusive Payment Systems**

Interested APEC developing economies should facilitate the accelerated development of alternative payment channels by introducing digital identities and interoperable consumer ID to promote digital financial services, promoting responsible digital financial practices to ensure consumer and data protection, creating coordinating policy agencies to oversee digital financial sector deployment, and establishing Common Digital Financial Services Indicators to measure and track progress.

## **2. ACCELERATING REGIONAL FINANCIAL INTEGRATION**

### **Accelerating the Integration of Local Currency Bond Markets**

Regulators and the private sector in Asia-Pacific developing economies should strengthen their collaboration to address challenges faced by long-term institutional investors in investing in cross-border local currency corporate bonds as well as cross-border corporate issuances in these markets.

### **Designing Inter-Operable Funds Passport Schemes in APEC**

APEC economies should agree to promote inter-operability of funds passports in the region and identify the modality for achieving this goal.

### **Promoting the Emergence of Inter-Operable Real-Time Payment Systems**

Central banks and relevant public and private sector stakeholders should work together to establish robust and regionally interoperable real-time payments infrastructure based on international standards.

### **Catalyzing the Development of a Regional Catastrophe Bond Market**

APEC Finance Ministers should work with multilateral organizations to catalyze the development of an Asia-Pacific catastrophe bond market through the issuance of cat bonds for developing Asian member economies starting in 2020, learning from the experience of the Pacific Alliance cat bond.

## **3. IMPLEMENTATION OF THE CEBU ACTION PLAN AND FINANCE MINISTERS' PROCESS INITIATIVES**

We recommend that APEC Finance Ministers welcome the 2019 Progress Report of the Asia-Pacific Financial Forum (APFF), the Asia-Pacific Financial Inclusion Forum (APFIF) and the Asia-Pacific Infrastructure Partnership (APIP).

We also recommend that they endorse the following documents developed by APFF and submitted by ABAC last year, which have been discussed by Finance and Central Bank Deputies and Senior Finance Officials and finalized this year:

- An APEC Roadmap for a New Financial Services Data Ecosystem;
- A Strategy for the Digitalization of Trade and Supply Chain Finance; and
- Essential Elements of an Effective Personal Insolvency Regime.



# APEC BUSINESS ADVISORY COUNCIL 2019 REPORT TO APEC FINANCE MINISTERS

## Introduction

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This year, ABAC focuses its Report to APEC Finance Ministers on two of the most important issues for APEC.

The first is **financial inclusion**. All around the world, over 1.6 billion adults do not have a bank account. Of these, 556 million -- 40 percent -- live in APEC member economies.<sup>1</sup> The World Bank estimates that in middle and low-income APEC developing economies, around 70 million MSMEs (45 percent of their combined total) have insufficient access to credit.<sup>2</sup> Financial inclusion is critical to the emergence of a broad consumer and entrepreneurial base that can ensure that the benefits of trade and investment are shared and supported widely by the people of the Asia-Pacific region.

The second issue is **regional financial integration**. Rapid growth of trade in goods and services across the region has driven increasing integration among APEC members. However, this has not been accompanied by a similar growth of cross-border financial services among developing economies. Regional financial integration is vital to the development of domestic financial markets and the efficient allocation of capital across the region.

We hope that by developing recommendations to address these two important issues, ABAC can help identify deliverables that can be incorporated in the APEC Finance Ministers' update of the Cebu Action Plan's financial integration pillar and contribute to the realization of their vision of growth.

## I. Creating the Digital and Policy Ecosystem for Financial Inclusion

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Digital technology has played an important role in overcoming barriers to financial inclusion. Today's technologies,<sup>3</sup> combined with the exponential growth in the volume of data – especially unstructured or “big” data – that can be used to provide risk-based financial services, offer unprecedented opportunities for financial service providers to finally reach the unbanked and the vast majority of MSMEs.

However, the pace of financial innovation has been uneven across the region. The more developed member economies and China have led the way, but growth of innovation has not been as fast in most developing economies. In ASEAN economies, more than 80% of banks do not have the labs and accelerator programs needed to drive digital transformation. Their success rate of moving from prototype to the pilot stage of financial innovation is low (at 30-40 percent). In the case of fintech firms in ASEAN, the success rate of moving from one stage to the other has been even lower (at 10-20 percent).<sup>4</sup>

Another fundamental challenge is that much still needs to be done before new technologies can be adopted in financial services. In many economies, laws, policies, regulations and institutional arrangements have been built around finance to serve a broad array of public policy objectives. These include financial stability, consumer and

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<sup>1</sup> The unbanked comprise more than a third of the population of Vietnam, Mexico, Peru, Philippines and Indonesia. The percentages are 51.6 percent for Vietnam, 45.4 percent for Mexico, 43.8 percent for the Philippines, 39 percent for Peru, and 36.6 percent for Indonesia. There is no data from some APEC member economies. World Bank, *The Global Findex Database 2017* [<https://globalfindex.worldbank.org/node>].

<sup>2</sup> Data are for 11 fully and partially credit-constrained MSMEs in APEC economies (percentage of credit-constrained MSMEs in each economy in parenthesis): Chile (22%), China (41%), Indonesia (53%), Malaysia (38%), Mexico (35%), Papua New Guinea (32%), Peru (45%), Philippines (13%), Russian Federation (48%), Thailand (55%) and Vietnam (15%). Fully credit-constrained firms are defined as those that find it challenging to obtain credit. Partially credit-constrained firms are defined as those that have been somewhat successful in obtaining external financing, but were discouraged from applying for a loan from a financial institution or applied for a loan that was then partially approved or rejected. The World Bank estimates the funding gap (between supply and demand for credit) for MSMEs in 9 of these economies at USD2.5 trillion. Funding gap estimates for PNG and the Philippines are not available. Source: World Bank, *MSME Finance Gap Report 2017*, 2018-19 updates [<https://www.smefinanceforum.org/data-sites/msme-finance-gap>].

<sup>3</sup> These include artificial intelligence and machine learning, cloud computing, biometrics, distributed ledger technology, advanced analytics, optical character recognition and the Internet of Things, among others.

<sup>4</sup> As cited by AFIN in its presentation *ASEAN Financial Innovation Network* on 29 March 2019 in Tokyo, Japan based on data from market research in ASEAN, Deloitte Research, and United Overseas Bank, *State of Fintech in ASEAN*.

investor protection, privacy, fair competition and prevention of the system's use by criminals and terrorists. In others, particularly developing economies, the financial infrastructure such as those for credit information, asset-based lending and payments, as well as the IT infrastructure, are still underdeveloped.

Thus, harnessing digital technology to achieve financial inclusion will require simultaneous efforts on many fronts. These efforts include identifying mechanisms to accelerate the diffusion of technology in the financial sector of developing member economies. They also include the modernization of legal, policy, regulatory and institutional ecosystems to enable the adoption of digital technology and the wider use of data in financial services. Care must be taken to ensure that measures taken are consistent with fostering innovation, which in certain cases may be best achieved by adopting a regulatory stance at a later stage, as a last resort or through a sandbox that provides a clear path to market-wide deployment.

### **ACCELERATING FINANCIAL INNOVATION: THE ROLE OF REGIONAL PUBLIC-PRIVATE PLATFORMS**

The process for matching technology with financial service providers, and designing, developing, and testing products in many developing economies is often long and expensive. A solution to this challenge is the establishment of regional public-private platforms for financial innovation. One example of such a platform is the ASEAN Financial Innovation Network or AFIN, a partnership among the ASEAN Bankers' Association, the Monetary Authority of Singapore and the IFC/World Bank Group.

After its incorporation in 2018, AFIN established an innovation sandbox called APIX.<sup>5</sup> APIX provides a curated platform for financial institutions to discover and filter credible fintech firms and collaborate with them in designing and testing prototypes and deploying innovative products and services. For fintech firms, it provides a secure platform to discover needs of financial institutions and offer solutions. It also enables regulators to observe these activities and test and approve products that meet their regulatory requirements for introduction in their domestic markets.

Through this platform, financial institutions and fintech firms can collaborate to develop and deploy innovative products more rapidly and at lower cost. It allows participating regulators to deepen their understanding of financial innovation in their markets by observing activities in the platform. Regulators and industry bodies in other parts of the region can learn from this experience. This is, for example, the case in Latin America, where fintech firms and banks are looking for ways to accelerate innovation and expand regional operations.

#### **Recommendation #1-A:**

**APEC Finance Ministers should encourage collaboration among regulators, industry and multilateral institutions to develop, implement, link together and deepen participation in public-private sector platforms for financial innovation across the region. As a first step forward, we recommend that APEC convene a Roundtable in Latin America to share Asian experiences with platforms that facilitate international partnerships among banks and fintech firms to design, test and deploy innovative products, and to develop the concept for a Latin American platform that can be linked with Asian counterparts.**

### **HARNESSING DATA FOR FINANCIAL INCLUSION**

Rapid development of technologies has created new opportunities for consumers and MSMEs to access credit. New business models are emerging and technology companies are expanding into financial services. Many traditional financial institutions are revamping business processes and IT architectures. They are adopting new business models based on the incorporation of alternative data into evaluation of customers' operating conditions, early warning risk indicators and credit decision-making. These processes rely on the integration of internal data systems and external data sources, and highlight the importance of access to data.

#### **Recommendation #1-B:**

**Economies should promote wider collection and sharing of traditional and alternative data, including both negative and positive credit data, as well as unstructured data (Big Data) and take steps to improve**

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<sup>5</sup> Since APIX was set up in November, 103 fintech firms and 38 financial institutions from 22 markets have used it to develop various innovative products (as of end-March 2019).

## availability, connectivity and quality of information.

Concrete steps to achieve this objective include the following:

- *Non-sensitive public sector data relevant for business.* Governments should lead the way in improving public data quality and connectivity, in line with the APEC Connectivity Blueprint. Ways to do this include: (a) enhancing digital capability by increasing investment in technology and improving information systems; (b) increasing data quality and sharing through harmonized data standards and rules on data collection, integration, application and security; (c) developing concrete steps, ways and scope for sharing of public data; and (d) providing single-point access to public data through a unified data sharing portal.
- *Structured data.* Economies should review their legal and regulatory frameworks for credit reporting and undertake reforms where needed to enable the collection and sharing of both negative and positive data as well as alternative data. These reforms should be guided by the World Bank's *General Principles for Credit Reporting*. Additional measures include (a) public credit registry guidance and capacity building; (b) advancing use of credit file data for ID verification, KYC, AML, and data security applications; and (c) holding FIDN workshops for credit registries and bureaus to address range of topics as needed.
- *Unstructured data.* Economies should develop a balanced regulatory approach toward the new data and analytics industry that fosters innovation while protecting consumers and financial system integrity. Elements of such a balanced approach include: (a) a principles-based comprehensive law or over-arching regulation on personal data protection; (b) a general personal data regulator with capacity to implement and enforce rules; (c) a self-regulating independent industry association that plays a role in developing codes of conduct and market-based standards in collaboration with regulators; (d) an efficient and low-cost complaint, correction and dispute resolution mechanism, particularly out-of-court procedures; (e) rules governing cross-border data cooperation, investigations and data flows; and (f) specific financial sector regulations and guidelines for firms providing financial services.

### Recommendation #1-C:

**Economies should engender trust in wider cross-border data flows by collaborating to develop inter-operable privacy regimes among themselves and with other key jurisdictions taking into account member economies' domestic laws, policies and priorities, and by cooperating to promote a strong regional data security environment.**

This could be achieved through the following actions:

- *APEC Cross-Border Privacy Rules (CBPR).* Interested member economies are encouraged to collaborate with the private sector to promote wider participation of businesses and economies in the CBPR, through appointment of accountability agents in all participating economies, lower certification costs, promoting awareness and other innovative schemes to enable more MSMEs to undergo APEC CBPR certification.
- *Privacy rules compliance for MSMEs.* APEC should establish a public-private sector task force to assist MSMEs in complying with data privacy rules. The task force should: (a) develop best practices for promoting RegTech and LegalTech to assist MSMEs in complying with privacy requirements; (b) develop core data standards to guide MSMEs and design limited safe harbor provisions for economies to adopt; and (c) vet and identify privacy enhancing technologies (PETs) that MSMEs can use to pool and share data.
- *Regional inter-operability of legal privacy regimes.* Interested member economies should establish a pathfinder initiative to undertake gap analyses of their privacy regimes with the APEC Privacy Framework as a basis for identifying measures needed to achieve inter-operability. These gap analyses should involve relevant agencies and regulators, the private sector and international organizations.
- *Inter-operability with the EU General Data Protection Regulation (GDPR).* The APEC E-Commerce Steering Group's Data Privacy Subgroup, on behalf of interested APEC economies, is encouraged to continue discussing and exploring options for collaboration on privacy and data protection with the European Commission, including seeking recognition of CBPR as a voluntary mechanism for certification of companies under the EU's system of binding corporate rules (BCRs). Once robust privacy laws are in place, APEC economies are also encouraged to hold talks with the EU to recognize their equivalence with GDPR.
- *Building capacity for data security.* APEC should establish a regional platform for public and private sectors

and international organizations to help developing economies improve their data security frameworks. These capacity-building efforts should work to (a) identify gaps in adoption of relevant data security standards, including risk-based security standards; (b) bridge those gaps and promote inter-operability through capacity-building seminars and technical assistance; (c) develop a long-term strategy for strengthening data security in the region; (d) develop innovative regional initiatives utilizing new technologies to enable wider data flows among member economies, especially those that can be used by MSMEs, that satisfy privacy and data security requirements; and (e) encourage the establishment of computer emergency or security incident response teams (CERTs or CSIRTs) focused on the financial sector where they do not yet exist, involving financial regulators, and promote regional cooperation among them.

## **DIGITALIZING TRADE AND SUPPLY CHAIN FINANCE**

Participation in global supply chains is important for MSMEs to benefit from and contribute to the region's economic integration. Global value chains offer MSMEs opportunities for growth by exposing them to a large and dynamic customer and buyer base, learning experiences from doing business with large firms and fertile ground for honing skills and innovative capacity to compete and win in the global marketplace.<sup>6</sup> In many developing economies, however, lack of access to working capital and loans has proven to be a major obstacle for MSMEs in taking advantage of these opportunities.

The trade finance gap (estimated using the rejected value of proposed trade finance transactions as reported by responding banks) is estimated by ADB as amounting to about USD 1.5 trillion in 2017. Most of the firms unable to obtain trade financing were MSMEs based in Asia and the Americas.<sup>7</sup> This is largely due to the fact that traditional trade financing (using letters of credit) is still largely manual and paper-based and is thus costly.<sup>8</sup> The high operational costs of traditional documentary trade, particularly for serving large numbers of small transactions typically involving MSMEs, has prompted more trade finance participants to shift from traditional documentary trade to open account transactions, where goods are delivered before payment is due, and where risks are mostly borne by the supplier. Many MSMEs, especially those from developing economies, remain dependent on traditional documentary trade.

Actual experiences have already demonstrated the benefits of digitalizing trade, and various digitalization projects, each operating with its own rules and practices and members, have emerged.<sup>9</sup> However, such platforms need to become inter-operable in order to avoid a proliferation of “digital fortresses” that would raise new costs, new barriers and new risks. Uncertainties over the validity of electronic documents related to acceptance of security or ownership across jurisdictions and digital islands result in continued reliance on paper documents, including digital documents being re-transformed back into paper documents handled manually after crossing borders. Enabling inter-operable digitalization of trade finance to benefit a wider base of MSMEs in developing economies will require addressing key policy and technical barriers, especially the inconsistent and unclear legal treatment of digital documents and the lack of standardized processes across jurisdictions.

### **Recommendation #1-D:**

**APEC economies should undertake measures to ensure that legal and regulatory frameworks around digital documents used in trade are inter-operable across the region, and support standardization of market**

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<sup>6</sup> ADB and Asian Development Bank Institute, *Integrating SMEs into Global Value Chains: Challenges and Policy Actions in Asia* (2017), pp. 3-5.

<sup>7</sup> Micro, small and midcap companies accounted for 74% of these rejected proposals. Trade within the APEC region is impacted by this gap – Asia and the Pacific accounted for 39% of the global total of rejected proposals and the Americas accounted for 23%, **Asian Development Bank, “2017 Trade Finance Gaps, Growth and Jobs Survey,”** *ADB Briefs* No. 83 (September 2017) [<https://www.adb.org/sites/default/files/publication/359631/adb-briefs-83.pdf>].

<sup>8</sup> A test shipment of flowers from Kenya to the port of Rotterdam done by IBM and Maersk involved processing of almost 200 documents. Such processes are estimated to amount to as much as 20% of physical transportation costs, World Economic Forum and Bain & Company, *Trade Tech – A New Age for Trade and Supply Chain Finance* [<https://www.weforum.org/whitepapers/trade-tech-a-new-age-for-trade-and-supply-chain-finance>].

<sup>9</sup> Examples are Bolero (<http://www.bolero.net/>), which was established by SWIFT and TT Club; EssDOCS Paperless Trade Solutions (<https://www.essdocs.com/>); Project Voltron (<https://www.ledgerinsights.com/blockchain-trade-finance-voltron-hsbc-letter-of-credit/>) initiated by several banks in the R3 consortium; the Marco Polo Network (<https://www.marcopolo.finance/>); Hong Kong e-Trade Connect (<https://www.hkbea.com/html/en/bea-etradeconnect.html>); NTT Data Trade Platform ([http://www.cicc.or.jp/japanese/kouenkai/pdf\\_ppt/pastfile/h30/190221-2.pdf](http://www.cicc.or.jp/japanese/kouenkai/pdf_ppt/pastfile/h30/190221-2.pdf)); Singapore's Networked Trade Platform (<https://www.ntp.gov.sg/home/>); and Thailand's electronic Letter of Guarantee (e-LG) network on blockchain via BCI (Thailand) Co Ltd (<https://www.thailand-business-news.com/banking/72952-thailand-launches-blockchain-letters-of-guarantee-network-for-22-banks.html>).

## practices.

Concrete measures should include the following:

- APEC economies should establish a pilot project to digitalize specific supply chain corridors among three or more interested economies. This pilot project would help identify key barriers and specific areas where reform is needed, such as where existing free trade agreements need to be reviewed to facilitate the cross-border use of digital documents and the legal recognition of digital signatures in digital title transfer documents, and where common standards and inter-operability need to be developed.
- APEC economies should review their legal and regulatory frameworks and free trade agreements. Where needed, they should undertake reforms to facilitate digitalization of manual and paper-based processes. In particular, economies should review their laws and align them as appropriate with the UNCITRAL Model Law on Electronic Transferable Records.
- APEC Finance Ministers should encourage relevant stakeholders to support industry efforts to standardize market conventions and technology protocols, particularly digital rules for trade finance, including the adoption of established digital security and technology standards for document management and exchange.

## **BUILDING THE ECOSYSTEM FOR A MODERN MOVABLES FINANCE MARKET**

Using movable assets as collateral has been a major source of financing for SMEs in advanced markets. In many developing economies, however, lenders have traditionally accepted only real estate as collateral, due to underdeveloped legal frameworks and lack or inadequacy of collateral registries for movable assets. Since 2015, several member economies have initiated legal reforms and actions to establish unified collateral registries under the Cebu Action Plan, and some of these measures have been completed. To accelerate the development of the movables finance markets, bring them into the digital age and align them with APEC's goal of regional integration, new initiatives are needed.

### **Recommendation 1-E:**

**APEC should initiate capacity building programs for interested economies under the Cebu Action Plan's Financial Infrastructure Development Network (FIDN) to build a modern movables finance market focusing on market development, digitalization and globalization.**

Concretely, these initiatives will need to address the following:

- *Market development.* Initiatives should aim to (a) deepen regulators' and lenders' understanding of movable asset finance and issue relevant policies and guidelines;<sup>10</sup> (b) develop supporting services, including collateral management and credit/professional liability insurance; and (c) develop non-bank market players.
- *Digitalization.* Initiatives should aim to (a) create an enabling environment for e-platforms,<sup>11</sup> including distributed ledgers that can promote efficiency and reduce the cost of their inter-operability; and (b) digitize financing instruments such as digital invoices and digital warehouse receipts.
- *Globalization.* Relevant APEC fora<sup>12</sup> should undertake dialogues with developing economies to promote inter-operability of secured financing systems across jurisdictions.

## **EXPANDING ACCESS TO A BROADER RANGE OF FINANCIAL SERVICES**

Promoting access to credit has been a major focus of financial inclusion efforts. However, a more holistic view that affirms the importance of promoting access to a broader range of financial services, including savings, insurance, pensions and payments alongside credit has emerged, underscoring the shifting landscape of financial services as they are reshaped by digital technology and new business models. Policy and regulatory reforms are key to providing an enabling environment for financial innovation powered by digital technology to benefit disadvantaged groups of people such as the poor, women, disabled, young people and those living in rural and

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<sup>10</sup> Including development of competence in several innovative movables approaches, such as asset-based lending and supply chain finance.

<sup>11</sup> E.g., e-platforms for receivables finance, warehouse receipts finance and supply chain finance.

<sup>12</sup> These are the APEC FMP, the Economic Committee's Strengthening Economic and Legal Infrastructure (SELI) Coordinating Group, the APEC SME Working Group and the APFF.

remote areas.

### **Recommendation #1-F:**

**APEC developing economies should undertake reforms to expand access of rural and low-income consumers and micro-enterprises to savings, insurance and pensions, using digital technology, and promote financial literacy.**

Concrete reforms should include the following:

- *Access to savings:* (a) Governments should start digitizing G2P and P2G payments to drive more savings toward formal digital channels. (b) Governments should promote e-commerce among unbanked households to encourage opening accounts. (c) Regulators should support development of tiered KYC compliance and use of e-KYC to allow simplified and remote account opening. (d) Regulators and relevant agencies should support innovations through financial and digital literacy and consumer protection for new products and improvement of rural ICT infrastructure.<sup>13</sup>
- *Access to insurance:* (a) Regulators should use the existing Mutual Exchange Forum on Inclusive Insurance (MEFIN) platform to develop policy frameworks, proportionate regulations on the use of technology, and scalable business models. (b) Finance ministries should convene a roundtable among key stakeholders to establish mechanisms for inter-agency coordination and public-private collaboration.
- *Access to pensions:* (a) Governments should develop strategies to incentivize people to join pension fund schemes, focused on education and awareness and technologies such as digital KYC and robo-advisors. (b) Relevant public sector stakeholders (such as ministries of finance and labor and key regulatory agencies) should convene a roundtable to promote awareness of the importance of pension funds for the development of the capital market and infrastructure and agree on coordinated action.

### **CREATING INCLUSIVE PAYMENT SYSTEMS**

Payment systems provide an essential financial service that enables businesses and individuals to manage their daily financial activities. Payment services also constitute a gateway to other financial services such as savings, investment and credit, and are critical to the efficient provision of these other services.<sup>14</sup> Access to affordable retail payment services has been a major financial inclusion issue due to the high costs of making transfers through the traditional banking system. This has presented opportunities to alternative payment service providers, especially with the emergence of digital technologies.

However, the development of these alternative payment services requires an enabling environment, of which the following are key elements:

- *Inter-operable digital identification of consumers.* Digital IDs are an important foundation of public digital infrastructure, an enabling technology sitting across access networks vital to establish trust between parties. They are pivotal in interactions among individuals and institutions, including the delivery of public services, e-commerce, financial services, education and health care. When combined with the use of mobile devices, universal digital IDs: (a) make it easier for the unbanked to obtain financial accounts by simplifying the documentation requirements at account opening; (b) help financial institutions comply with customer ID components of customer due diligence (CDD) requirements in a cost-effective way, especially if agents have biometric compatible technology that does away with the need for physical presence of customers or financial institution personnel; and (c) contribute to financial sector deepening through the creation of credit histories for previously unserved customers, thus allowing service providers to better monitor customer behavior and liabilities and accordingly offer new services such as credit and insurance.
- *Responsible digital financial practices to protect consumers and data.* Alternative payment and distribution channels involve a variety of new services and business models that offer opportunities for financial inclusion through personalization of service, convenient access and lower acquisition, transaction and settlement costs.

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<sup>13</sup> Examples are product innovations such as online rotating savings and credit associations (ROSCAs) and channel innovations such as digital agent banking.

<sup>14</sup> Committee on Payments and Market Infrastructures (CPMI) and the World Bank Group, *Payment aspects of financial inclusion* (April 2016) [<http://documents.worldbank.org/curated/en/806481470154477031/pdf/107382-WP-REPLACEMENT-PUBLIC-PAFI-Report-final-in-A4.pdf>].

These may include, among others, peer-to-peer (P2P) lending platforms, new credit rating services or government transfers through integrated digital channels that are enabled by efficiencies from the use of digitalization and data analytics and targeting. However, the rapid broadening of constituencies also entails stronger consumer and data protection, particularly for the most vulnerable segments of society. This is important to engender more trust in these new payment channels and ensure their sustained development.

- *Stakeholder coordination in developing an enabling environment.* Nimbleness approaches by regulators and responsive policy framing are needed to provide conditions for digital initiatives to achieve scale and the ability to quickly and effectively respond to market needs through mass customer acquisition. Enabling digitalization, which cuts across sectors, requires collaboration and communication across various relevant government agencies and authorities that have often traditionally operated in silos. As costs and competitiveness are affected by choices of following localized or international standards, and as the flow of services across markets depends on the inter-operability of regulations, cross-jurisdictional collaboration is needed. Finally, involving non-government stakeholders is becoming increasingly important, since much of the expertise and knowledge involved in managing digital disruption and transformation resides in the private sector and the sustainability and inclusiveness of initiatives often require the support and active participation of civil society.
- *Measuring impact.* The ability to measure and assess impact of initiatives is important for their success and effectiveness. It is also important for maintaining political support, particularly for initiatives that require political decision-makers to expend political capital, such as those that enable new entrants to challenge incumbent service providers or those that involve geographical redistribution or redirection of resources. To do this, however, the dearth of consistent and effective measurement indicators needs to be addressed.

### **Recommendation #1-G:**

**Interested APEC developing economies should facilitate the accelerated development of alternative payment channels by introducing digital identities and interoperable consumer ID to promote digital financial services, promoting responsible digital financial practices to ensure consumer and data protection, creating coordinating policy agencies to oversee digital financial sector deployment, and establishing Common Digital Financial Services Indicators to measure and track progress.**

The following concrete actions are needed to implement this recommendation:

- Interested APEC economies should initiate discussions on the feasibility and requirements of an APEC Digital ID, which could eventually develop into the next iteration of the APEC Business Travel Card.
- Interested APEC economies should establish the following structures in their own jurisdictions as needed:
  - A Digital Finance Task Force, bringing together finance and relevant ministers involved in digital economy policies to undertake cross-sectoral coordination.
  - An overarching advisory body to ensure consumer protection and data protection in digital finance.
  - A task force to oversee the development of APEC Digital Finance Indicators and an APEC Digital Trade Index. Following initial development of these indicators, APEC member economies should collect and provide data to the APEC Secretariat for collation and analysis.

Further details are available in the payments landscape paper used as the basis for this analysis and recommendation: [https://www2.abaonline.org/assets/2019/Research/Payments\\_Landscape\\_Paper\\_2019.pdf](https://www2.abaonline.org/assets/2019/Research/Payments_Landscape_Paper_2019.pdf).

## **II. Accelerating Regional Financial Integration**

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Most economies in the region have already been for a long time to a significant extent financially integrated with major global financial centers. However, the progress of intra-regional financial integration, especially among developing economies, has been slow. Considerable amounts of savings in developing economies are flowing to advanced markets before being recycled back to meet the huge needs of the region for financing infrastructure and enterprise expansion. Several Asia-Pacific economies are important markets for fund management products manufactured in Europe, including those that invest capital back into the region. Impediments to regional financial integration have hindered the development of financial markets and kept financial services costly and inconvenient.

Various initiatives are being undertaken to integrate different parts of the Asia-Pacific financial market. These include the Asian Bond Markets Initiative and Asian Bond Fund, the ASEAN+3 Bond Market Forum, the ASEAN

Economic Community, the Pacific Alliance Integrated Latin American Market (MILA), the Asia Region Funds Passport (ARFP), and the Pacific Alliance Funds Passport, among others. However, many obstacles remain to be addressed, such as the lack of inter-operability of regulations and market infrastructure, disincentives due to different tax treatment, siloed practices of market players and lack of common standards for documentation and processes, among others.

Stronger regional collaboration can help accelerate progress in integrating financial systems among APEC member economies, along with other non-member economies in the region. This will benefit the region in terms of increasing depth and liquidity of securities markets, expanding the range of products and diversification opportunities for investors, and more direct and efficient channeling of capital to investment within the region. Such collaboration can promote lower transaction costs and shorter payment cycles, facilitate the establishment of new markets that the region needs, such as the market for insurance-linked securities, and enable the growth of sophisticated financial services and financial centers in the region.

## **ACCELERATING THE INTEGRATION OF LOCAL CURRENCY BOND MARKETS**

Local currency bond markets are critical for many reasons. They help finance infrastructure projects crucial to supporting economic growth. They can channel excess savings in the region to fund long-term investment needs of Asia-Pacific economies. They can help economies avoid the double mismatch issue that caused the Asian Financial Crisis. They are critical to promoting and deepening the domestic long-term investor base. The most important challenge facing local currency bond markets in the region's developing economies is the lack of depth and liquidity, which is due in large part to the lack of a large and diverse investor and issuer base.

The expansion of cross-border investment and issuance across markets supported by a harmonized framework can help attract a larger number of diverse investors, increase market depth and liquidity, and promote regional integration. Stronger collaboration among regulators, officials, and the private sector focused on addressing issues identified by market participants can help accelerate this process.

### **Recommendation #2-A:**

**Regulators and the private sector in Asia-Pacific developing economies should strengthen their collaboration to address challenges faced by long-term institutional investors in investing in cross-border local currency corporate bonds as well as cross-border corporate issuances in these markets.**

As a concrete starting point, regulators and the private sector should initiate closer collaboration through regional platforms such as the ASEAN+3 Bond Market Forum (ABMF) and the APFF to focus on the following:

- Facilitating cross-border investment by institutional investors in local currency corporate bond markets through: (a) more harmonized bond market standards; (b) addressing tax disincentives such as withholding tax; (c) improving certainty and transparency of local custody systems; and (d) making onshore foreign exchange and interest rate hedging tools available to these investors.
- Enabling more cross-border issuances through: (a) use of a market-driven common issuance format broadly accepted by institutional investors and borrowers; (b) progressive alignment of regulatory processes to reduce issuance costs;<sup>15</sup> and (c) benchmarking measures against US Regulation S and Euro Medium Term Note (EMTN) standards that are currently favored by corporate issuers in Asia.

A conference should be convened by Latin American APEC member economies using the Pacific Alliance platform to discuss bond market integration, including lessons from the ABMF experience, to develop a strategy for bond market integration among them and inter-operability with Asian economies.

## **DESIGNING INTER-OPERABLE FUNDS PASSPORT SCHEMES IN APEC**

The EU's experience in establishing and advancing the Undertakings for Collective Investments in Transferable Securities (UCITS) and the eventual success of the scheme inspired the emergence of several similar initiatives in the region. There are now four funds passporting schemes involving APEC member economies – the Mainland-

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<sup>15</sup> E.g., by reducing additional compliance or due diligence costs for offering in a jurisdiction bonds that have already been approved or registered in another member jurisdiction.

Hong Kong Mutual Recognition of Funds (MRF), the ASEAN Collective Investment Scheme, the Asia Region Funds Passport (ARFP) and the Pacific Alliance Funds Passport. The ARFP is now operational, with Australia, Japan and Thailand having commenced accepting applications from domestic and foreign funds in February this year. In order to attract market participants to manufacture and distribute funds products in the region, the different stakeholders of each of these schemes need to agree to work toward inter-operability.

### **Recommendation #2-B:**

**APEC economies should agree to promote inter-operability of funds passports in the region and identify the modality for achieving this goal.**

As a first step, ARFP and Pacific Alliance should begin discussions on various options, which could include (a) inter-operability based on similar fundamentals, under which each fund passporting scheme shares sufficient levels of sophistication in areas fundamental to passporting arrangements across their constituent members;<sup>16</sup> (b) inter-operability with an additional barrier (layer of compliance or clearance);<sup>17</sup> or (c) inter-operability through bilateral passporting of individual scheme members.<sup>18</sup>

### **PROMOTING THE EMERGENCE OF INTER-OPERABLE REAL-TIME PAYMENT SYSTEMS**

Batch electronic funds transfer systems for large-volume low-value transfers constitute one of the most widely used payments channels. With the rapid growth of non-cash payments, market participants are now transitioning from the current systems that are processed in batches and settled the next day, to allow continuous operation, reduce systemic risk, accommodate future growth and drive increased commercial activity. To date, many APEC economies have developed or are developing domestic instant payment mechanisms. However, many of these are either nascent or are limited to the domestic market. Various measures could therefore be taken to help existing domestic initiatives to develop and move towards interoperable cross-border instant payments, which are important for regional integration, efficiency of cross-border financial transactions, innovation, inclusion and integrity of payment and settlement systems.

### **Recommendation #2-C:**

**Central banks and relevant public and private sector stakeholders should work together to establish robust and regionally interoperable real-time payments infrastructure based on international standards.**

- A real time payments capacity building program should be established to foster dialogue<sup>19</sup> and coordination among economies. Given work already underway on real time payments in ASEAN, it is recommended that a pathfinder group be formed by member central banks of the ASEAN Working Committee on Payment and Settlement Systems (WCPSS) using its platform, supported by collaboration with representatives from the private sector, including banks, payment companies and their representative associations. The pathfinder group would:
  - Undertake an analysis of domestic instant payment mechanisms across ASEAN in order to increase region-wide understanding and identify capacity gaps and capacity building opportunities.

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<sup>16</sup> These areas can include: (a) eligible investment asset classes; (b) custody arrangements; (c) offer document conditions; (d) registration arrangements; (e) asset management business licensing; (f) limits on leverage (if any); (g) liquidity requirements; (h) client acquisitions and AML/KYC requirements; (i) taxation (investor level, fund level and investment level); and (j) investor protection and dispute resolution procedures. Where constituent members of the respective fund passporting schemes are satisfied that their counterparts have an adequately mature industry, measured perhaps in part by the criteria above, they may allow all members of the other fund passporting scheme access to their scheme and vice-versa.

<sup>17</sup> In this option, where one passporting scheme may comprise economies of a similar level of development and maturity, another may have a less homogenous pool on constituents as members. This could lead to discrepancies in regulatory approaches, investor protections and licensing requirements. In this situation, the passporting schemes may establish additional barriers for individual economies to clear before they can be granted access under the scheme. This can serve to block economies that are not at the required levels while granting access to those that are.

<sup>18</sup> In some instances, economies may be part of a wider group of jurisdictions but operate in some manner which is inconsistent to the fundamental principles of jurisdictions in another group. Under this model, while economies may meet the requirements of the respective fund passporting schemes, individual jurisdictions would be able to block participation of specific economies in their funds market when needed due to specific circumstances.

<sup>19</sup> Dialogues to develop regionally consistent views across APEC should revolve around the following building blocks: (a) replacing batch settlements with mechanisms based on increasingly frequent settlements and round-the-clock service; (b) adequate legal frameworks that promote consumer protection, digital ID verification and increased transparency; (c) consistent capital and regulatory requirements for banks and non-banks that reduce systemic risk and establish a level competitive playing field; (d) strong incentives for early adoption, including maintaining low fees and transaction costs; and (e) capacity to build innovative value-added features on top of instant payment rails to improve options for consumers and businesses.

- Explore existing linkages between instant payments mechanisms and identify learnings based on the collective experience of member economies, looking in particular at how to grow cross-border instant payments among participating economies.
  - Develop specific recommendations for future growth and expansion of instant payment mechanisms which could then be utilized across the wider APEC region.
- An Asia-Pacific real time payments advisory group should be established to support the capacity building program and identify best practices across APEC. This group should include representatives from both the public and private sectors and focus on drawing on established best practices to assist economies as they develop instant payment mechanisms.
  - APEC member economies should accelerate discussions with relevant stakeholders in the private sector to agree on the adoption of an international standard for messaging.

## **CATALYZING THE DEVELOPMENT OF A REGIONAL CATASTROPHE BOND MARKET**

The successful issuance of the Pacific Alliance catastrophe bond by the World Bank in 2018 demonstrated their potential to fill important gaps in economies' disaster risk financing frameworks. Strong investor demand for the cat bond (which was oversubscribed) reflected the market's appetite for assets that are uncorrelated with broader financial markets and can deliver good returns. While cat bonds have been familiar features in developed markets for many years, they are still relatively unknown in most emerging markets in APEC.

### **Recommendation #2-D**

**APEC Finance Ministers should work with multilateral organizations to catalyze the development of an Asia-Pacific catastrophe bond market through the issuance of cat bonds for developing Asian member economies starting in 2020, learning from the experience of the Pacific Alliance cat bond.**

As an initial step, we recommend that the Disaster Risk Financing and Insurance (DRFI) Solutions Working Group under the APEC Finance Ministers' Process include catastrophe bonds in its work program. The Working Group should convene a workshop in early 2020 involving interested economies, multilateral organizations, private sector experts and potential investors to discuss optimal features of cat bond issues suitable for developing member economies, and decide on a concrete way forward. We propose that the Working Group work toward the issuance of a first cat bond under its auspices in 2020.

## **III. Implementation of the Cebu Action Plan and Finance Ministers Process Initiatives**

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ABAC encourages the APEC Finance Ministers to continue advancing the implementation of the Cebu Action Plan and other FMP initiatives. Through the APFF, APFIF and APIP, we are pleased to help in providing public-private sector platforms to mobilize contributions to this effort from the private sector in collaboration with international and public sector organizations. ABAC is pleased to submit to Finance Ministers the 2019 Progress Report of the APFF, APFIF and APIP. The Executive Summary of this Progress Report is appended to this Report, while the full text can be downloaded through this link:

[https://www2.abaonline.org/assets/2019/AGFSCB\\_Reports/Complete\\_2019\\_Progress\\_Report\\_of\\_APFF\\_APFI\\_F\\_and\\_APIP\\_Final\\_Version.pdf](https://www2.abaonline.org/assets/2019/AGFSCB_Reports/Complete_2019_Progress_Report_of_APFF_APFI_F_and_APIP_Final_Version.pdf).

We recommend that APEC Finance Ministers welcome this Progress Report. We also recommend that they endorse the following documents developed by APFF and submitted by ABAC last year, which have been discussed by Finance and Central Bank Deputies and Senior Finance Officials and finalized this year:

- An APEC Roadmap for a New Financial Services Data Ecosystem;
- A Strategy for the Digitalization of Trade and Supply Chain Finance; and
- Essential Elements of an Effective Personal Insolvency Regime.

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